

Message Text

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SUBJECT: KOREAN FRIGATE PROJECT

REFS: (A) STATE 162375; (B) SEOUL 3485

1. ON JULY 1 EMBASSY DISCUSSED REF A INFORMATION WITH HYUNDAI SHIPBUILDING'S H.Y. CHUNG AT LENGTH AND CONFIRMED IN SUBSTANCE J.J. MCMULLEN'S (JJMA) REPORT TO SIPS OF USDOC. ADDITIONALLY, EMBASSY HAS SPOKEN WITH BASILE OF JJMA DIRECTLY AND GENERAL ELECTRIC MARINE SALES DIRECTOR, E.M. RAWSON, IN EFFORT TO CLARIFY PROBLEM AREAS AND DETERMINE IF COMPROMISE BETWEEN HYUNDAI AND JJMA IS POSSIBLE. RAWSON VISITING SEOUL TO MARKET LM2500GAS TURBINE WHICH IS LEADING U.S. CANDIDATE FOR FRIGATE PROPULSION SYSTEM.

2. ACCORDING TO HYUNDAI (CHUNG) ROK PRESIDENT PAK APPROVED ON JUNE 25 LOCAL FUNDING AND GRANTING OF ROK GOVERNMENT GUARANTEES TO FOREIGN LOANS FOR LEAD VESSEL OF FRIGATE PROGRAM. WHILE HYUNDAI AND ALL ELEMENTS OF ROK GOVERNMENT INCLUDING BLUE HOUSE DESIRE, ALL OTHER CONSIDERATIONS BEING EQUAL, TOTAL U.S. PARTICIPATION IN PROJECT, HYUNDAI HAS ALSO BEEN TOLD THAT IF CONDTIONS OF U.K. DESIGN OFFER ARE BETTER THAN THOSE OF JJMA HYUNDAI HAS PERMISSION TO NEGOTIATE AND SIGN CONTRACT WITH NON-U.S. FIRM.

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3. HYUNDAI SEES THREE PROBLEM AREAS IN ITS NEGOTIATIONS WITH JJMA: (1) HYUNDAI INSISTENCE ON JJMA PERFORMANCE GUARANTEE, (2) JJMA INABILITY LIVE WITH LACK OF PAYMENT GUARANTEE IN CONTRACT, AND (3) JJMA DISSATISFACTION WITH HYUNDAI PROPOSED PAYMENT SCHEDULE. ON LAST POINT JJMA CLAIMS THAT HYUNDAI CONTRACT WILL REQUIRE JJMA TO WORK THROUGHOUT PROGRAM WITH NET CASH FLOW DEFICIT OF OVER \$2 MILLION. HYUNDAI, IN JULY 1 CONVERSATION, STATED THAT U.K. DESIGN FIRM HAS ACCEPTED ALL PROVISIONS OF HYUNDAI CONTRACT AND THAT SAME FIRM, Y-YARD, HAS CONTRACTED WITH HYUNDAI FOR DESIGN SERVICES PREVIOUSLY UNDER SIMILAR ARRANGEMENTS. ALTHOUGH BASILI INDICATED IN CONVERSATION WITH EMBASSY THAT HE WILLING TO COMPROMISE ON POINT (1), HE INDICATED THAT JJMA WOULD NOT AGREE TO HYUNDAI'S POSITIONS ON (2) AND (3). MOST RECENT HYUNDAI TELEX ASKED JJMA FOR DEFINITE READING BY 30 JUNE. BASILI HAS TOLD EMBASSY HE PLANS TELEX HYUNDAI ON JULY 1 TO STATE JJMA CANNOT AGREE TO POINTS (2) AND (3).

4. CHUNG (HYUNDAI) SAW LITTLE CHANCE FOR COMPROMISE, NOTED THAT DESIGN CONTRACT WITH DOWN PAYMENT WILL PROBABLY BE SIGNED IN EARLY AUGUST, AND STATED HE NOW UNDER CONSIDERABLE CORPORATE AND GOVERNMENT PRESSURE TO MOVE AHEAD QUICKLY AS PRESIDENTIAL APPROVAL HAS BEEN OBTAINED. CHUNG EMPHASIZED THAT ALL ROK PARTIES VIEW DESIGN CONTRACT AND PROCUREMENT CONTRACT AS TWO SEPARATE COMMERCIAL AND POLITICAL ENTITIES. THAT IS, ALTHOUGH DESIGN NOW APPEARS LIKELY TO GO TO U.K. FIRM, A DECISION ON ACTUAL EQUIPMENT SOURCES FOR DETAILED DESIGN INCORPORATION WILL NOT BE MADE UNTIL OCTOBER-NOVEMBER 1976 AT EARLIEST. THUS, U.S. EQUIPMENT SUPPLIERS WITH GOOD FINANCING WOULD STAND CHANCE OF PROVIDING MOST IF NOT ALL OF FOREIGN PROCUREMENT PACKAGE. CHUNG NOTED, HOWEVER, THAT FOR U.S. SUPPLIERS THIS WILL BE AN UPHILL FIGHT AS U.K. FIRMS WITH STRONG U.K. GOVERNMENT BACKING HAVE FORMALLY PROPOSED, VIA E.C.G.D., AN APPROXIMATE US \$50 MILLION CASH LOAN TO HYUNDAI FOR LEAD SHIP PROCUREMENT. LOAN, AT 7--7.5 PERCENT INTEREST RATE, WOULD ALLOW HYUNDAI SOLICIT BIDS IN U.K. FOR SHIP EQUIPMENT. CHUNG IMPLIED THAT PROFF OF THIS LOAN ABILITY ON LESS-THAN-COMMERCIAL TERMS HAD BEEN CRUCIAL TO HYUNDAI'S RECEIVING RECENT GOAHEAD ON PROJECT. U.K. PROJECT LOAN, AS PRESENTLY OFFERED, DOES NOT INCLUDE FINANCING OF Y-YARD DESIGN BID. WHEN AND IF Y-YARD RECEIVED CONTRACT, COSTS WILL BE BORNE BY HYUNDAI FROM ROK GOVERNMENT AUTHORIZATION--HENCE HYUNDAI LIMITED OFFICIAL USE

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OBSESSION WITH CONCILIATORY TERMS.

5. CHUNG STATED THAT DURING RECENT VISIT OF US EXIM TEAM HE HAD QUERIED TEAM ON UNOFFICIAL BASIS AS TO WHAT EXIM REACTION WOULD BE TO ROKG/HYUNDAI REQUEST FOR FINANCING OF NON-WEAPONS PORTION OF FRIGATE PROJECT AND WAS TOLD THAT AS IT CLEARLY MILITARY EQUIPMENT, EXIM PROBABLY WOULD DECLINE ANY INVOLVEMENT. CHUNG NOTED THAT LACKING GOVERNMENT-SUPPORTED FINANCING U.S. SUPPLIERS

AS A GROUP WOULD PROBABLY BE IN A POOR POSITION TO COMPETE ON THIS PROJECT CONSIDERING U.K.'S WILLINGNESS TO SUPPORT ITS SUPPLIERS WITH THE LUMP SUM CASH LOAN AT THIS EARLY DATE.

6. CHUNG STATED THAT WEAPONS SYSTEMS WOULD BE U.S. AS WOULD, OF NECESSITY, ALL DESIGN AND CONSULTANT WORK RELATED TO WEAPONS SYSTEM ENGINEERING AND INTEGRATION. HE STATED THAT WEAPONS SYSTEM PORTION WAS "ROK NAVY PROBLEM AND RESPONSIBILITY FOR MOST PART", AND THAT HE ASSUMED ROK MND WOULD INCLUDE WEAPONS PROCUREMENT UNDER FMS REQUESTS CIRCA 1978 UNDER PRESENT HYUNDAI SCHEDULE. LEAD SHIP CONSTRUCTION WILL BEGIN CIRCA EARLY 1978 WITH EQUIPMENT PROCUREMENT CONTRACTS SIGNED IN 1977. HYUNDAI ALSO EXPLAINED THAT PRESIDENTIAL APPROVAL ALLOWED FUNDS FOR ONLY LEAD SHIP AND WHILE HYUNDAI AND ROK NAVY WERE RECOMMENDING FOUR OR SIX VESSEL PROGRAMS, NO FIRM DECISION WAS EXPECTED ON THIS POINT FOR ANOTHER YEAR OR SO.

7. COMMENT: CHUNG, IN ALL BUT CALLING JJMA OUT OF THE GAME, MATTER-OF-FACTLY EMPHASIZED THAT THE U.K.'S WILLINGNESS TO MAKE ALMOST ANY COMMERCIAL CONCESSION REQUIRED TO SECURE CONTRACT MADE U.S. COMPETITION, REGARDLESS OF HOW REASONABLE, DIFFICULT AT BEST. HYUNDAI HAS ENJOYED A TIGHT RELATIONSHIP WITH U.K. INDUSTRY SINCE THE CONSTRUCTION OF THE YARD, AND CHUNG ACKNOWLEDGED THAT MANY OF SAME E.C.G.D. OFFICIALS WHO PUT TOGETHER THE SHIPBUILDING EQUIPMENT PACKAGE FOR THE HYUNDAI YARD IN 1972 ARE NOW INVOLVED IN THE FRIGATE PROJECT, WITH CLOSE HYUNDAI COOPERATION, FOR SOME TIME. HYUNDAI FIRST AND FOREMOST WANTS THIS CONTRACT FOR ITS ORDER BOOK AND, WHILE IT WOULD WELCOME FULL

U.S. PARTICIPATION, IT IS MORE RECEPTIVE TO U.K. DESIGN, SERVICES AND EQUIPMENT OFFERED UNDER TERMS WHICH STRONGLY SUPPORT THE HYUNDAI ARGUMENT WITHIN THE KOREAN GOVERNMENT THAT THE PROJECT IS FUNDABLE AS WELL AS NECESSARY. EMBASSY DOUBTS LIMITED OFFICIAL USE

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THAT JJMA, GIVEN ITS PRESENT CORPORATE POSITION, CAN BEST U.K. OFFER AND WOULD BEST BE ADVISED SOONEST OF ABOVE INFORMATION AND EMBASSY READING OF SITUATION. SOME ROOM FOR HOPE, HOWEVER, DOES EXIST IN THAT ROK NAVY APPARENTLY STILL SUPPORTS A U.S. DESIGN AND EQUIPMENT EFFORT IN ITS DISCUSSIONS WITH HYUNDAI. EMBASSY WILL CONTINUE TO MONITOR THE SITUATION AS IT EVOLVES AND WILL REPORT SEPTEL ON OTHER ASPECTS OF THIS DECISION AS APPROPRIATE. VICE PRESIDENT BASILE, IN PHONE CONVERSATION WITH EMBASSY, REQUESTED EMBASSY VIA USDOC REPLY TO HIS REQUEST FOR ASSISTANCE AS SOON AS POSSIBLE. SNEIDER

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